Economic Outlook

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Irving Trust

Irving Trust Company
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Economic Research &
Planning Division

February 1984

The economy is once again sending off mixed signals. Some indicators have suggested a slowing in the pace of economic activity, while others have shown remarkable buoyancy. In any case, the economy will advance at a more moderate pace this year compared to last year, but the extent of the slowdown will influence the direction of interest rates.

It has been observed here and elsewhere that the recovery is generally progressing quite normally. For example, real GNP rose 6.1% from the fourth quarter of 1982 to the fourth quarter of 1983, compared to an average rise of 6.2% during the first year of prior recoveries. Our forecast of a 4.7% rise in real GNP from the fourth quarter of last year to the fourth quarter of this year would keep real GNP growth roughly on track with prior recoveries. Economic growth rarely proceeds at a steady rate, however, and the economy has shown some hesitation of late.

Industrial production showed steady deceleration during the second half of 1983, from a month-to-month increase of 2.3% in July to a rise of 0.5% in December. January probably showed improvement in industrial production as well as other monthly indicators, but certain factors point to a potential slowdown in the first half of 1984.

Housing starts have been roughly flat for about six months now, and the effects of this leveling off are beginning to show. Production of construction supplies had one of the sharpest rebounds among the major components of industrial production, but it remained flat during the fourth quarter of last year as housing starts stabilized. In addition, the change in business inventories is providing less thrust to the economy now, while the enlargement of the merchandise trade deficit is acting as a heavy drag on economic growth. Nevertheless, consumer demand remains relatively strong. As an indication, domestic auto sales hit 8.4 million units at an annual rate in January, the highest level since 1979. This pattern shows that various sectors of the economy are pulling in opposite directions, and the relative strengths will determine the pace of overall economic growth.

In recent testimony before Congress, Mr. Volcker indicated that members of the Federal Open Market Committee generally felt that real GNP would rise at a 4%-4 3/4% rate during 1984, which would be consistent with our overall forecast and the Fed's monetary targets. If real GNP falls below this range for any extended period, presumably--this was not explicitly stated--the Fed would feel some pressure to allow rates to fall. Nevertheless, the emphasis seemed to be on preserving the progress in controlling inflation. From a practical perspective, the conclusion is that the interdependency between real growth and interest rate movements will be particularly close this year. Without any major surprises in inflation or velocity growth, if real growth comes in below 4%--as we expect in the first half of 1984--interest rates may fall somewhat. Growth in the range of 4%-4 3/4% is probably consistent with a "steady as she goes" monetary policy. Extended growth much above 5%, however, is a sign to watch out for potential rate increases.

Bernard Schoenfeld

Irving Trust

Economic Forecast

Percent Changes at Annual Rates

	Actual								Forecast	Actual	Forecast	
	1983	1984				1984			1985	1982-	1983-	1984-
	IV	I	II	III	IV	I	II	III	IV	1983	1984	1985
Gross National Product	8.6	7.0	7.8	10.7	12.0	8.8	8.1	10.2	10.6	7.7	9.2	9.7
Real GNP	4.5	2.5	3.5	5.9	6.9	3.4	2.5	4.0	4.0	3.3	4.8	4.3
GNP Price Deflator	3.9	4.4	4.2	4.5	4.8	5.2	5.5	6.0	6.3	4.2	4.1	5.2

	Actual	Forecast	Actual	Forecast	
	1983: IV	1984: I	1982-1983	1983-1984	1984-1985
Consumer Spending	9.9%	8.7%	8.4%	9.1%	9.7%
Durable Goods	18.7	12.5	14.0	11.8	7.6
Nondurable Goods	5.6	1.8	5.7	6.0	6.7
Services	10.9	13.1	9.1	10.8	12.4
Business Capital Spending	25.1	7.0	-0.2	14.1	14.6
Structures	11.5	1.5	-7.4	7.8	13.0
Equipment	33.7	10.0	4.8	17.9	15.4
Residential Investment	-1.8	-2.3	43.8	12.5	-1.4
			1983	1984	1985
Change in Inventories	$17.7b.	$14.0b.	$-6.9b.	$18.4b.	$32.0b.
Net Exports of Goods and Services	$-32.6b.	$-38.0b.	$-10.6b.	$-44.0b.	$-55.0b.
			1982-1983	1983-1984	1984-1985
Government Purchases	2.0%	9.0%	6.3%	7.0%	8.6%
Federal	-3.6	16.6	6.4	8.6	11.8
Defense	10.4	14.7	11.6	11.6	14.0
Other	-33.9	22.4	-5.5	0.8	5.0
State & Local	5.7	4.5	6.3	5.9	6.5
Corporate Profits Before Tax	30.8*	30.7*	17.9	17.3	10.0
Corporate Profits After Tax	22.4*	25.4*	12.6	14.1	10.0
Plant and Equipment Expenditures	24.1	6.9	-4.2	12.0	12.5
Real Final Sales#	3.5	3.0	2.8	4.2	3.9
Real Disposable Personal Income	7.5	2.6	3.2	5.0	4.3

Economic Indicators	Recent Data			Actual	Forecast	
	Oct.	Nov.	Dec.	1982-1983	1983-1984	1984-1985
Consumer Price Index**	4.8%	3.6%	3.6%	3.8%	4.3%	5.5%
Producer Price Index for Finished Goods**	3.6	-2.4	2.4	0.6	4.3	4.9
Industrial Production	9.6	8.4	6.0	6.6	9.6	4.9
Retail Sales##	1.7	1.1	0.1	9.0	7.4	8.6
				1983	1984	1985
Auto Sales (millions of units, a.r.)	9.8	9.5	10.5	9.2	10.2	10.8
Housing Starts (millions of units, a.r.)	1.65	1.76	1.67	1.70	1.80	1.60
Unemployment Rate	8.8	8.4	8.2	9.6	7.6	6.8
Merchandise Trade Deficit (a.r.)	$107.6b.	$88.8b.	$75.6b.	$69.4b.	$104.0b.	$120.0b.

Unless noted otherwise, all data are period-to-period percent changes at annual rates, derived from seasonally adjusted data.

February 10, 1984

#GNP less change in inventories, both in real terms.
##Monthly percent changes are not annualized.
*Year-over-year percent changes.
**Annual percent changes are December to December (not seasonally adjusted).
$b. = billions a.r. = annual rate F = Forecast

Economic Outlook

3/22/84
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Irving Trust

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Economic Research &
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March 1984

The economy is continuing to display strong upward momentum--too strong perhaps, judging from the nervousness evident in the financial markets. If real growth continues to parallel the average of prior recoveries, as has been the case to date, real growth will be somewhat less robust than last year's pace. So far this year, however, the surprises have mainly underscored the economy's resilience. Unfortunately, one development is occurring as anticipated: The U.S. merchandise trade deficit hit a record $113.6 billion at an annual rate in January and is well on its way to reaching an all-time high of more than $100 billion for the year.

Both the apparent slowing of the economy in December and the subsequent rebound in January were probably unrepresentative of the true strength of the economy, partly because of the distortions caused by unusually heavy snows in December. A few indicators already show continued buoyancy in February, however, although others will undoubtedly show less powerful growth than in January. Nevertheless, economic growth remains relatively strong. This performance is the result of many factors, but two related ones in particular--replacement demand and pent-up demand--seem to be unusually important in this recovery.

Each year, many new cars are bought to replace older cars that have to be scrapped. (The process is often indirect as used cars are exchanged among various buyers and sellers.) As high car prices, the recession, and shifting priorities have caused many people to nurse their old clunkers along to an unusual extent, the average age of cars on the road has been rising steadily since 1970, reaching an estimated 7.4 years old in 1983, the highest since 1950. As more and more cars become candidates for scrappage, new car sales benefit.

This potential replacement demand may seem irrelevant when interest rates are high and workers are being laid off, but its effects become quite visible in an economic recovery. The unusual <u>length</u> of the past downturn in autos, however--the most extended in the post-World War II period--is probably causing replacement demand to be an especially powerful and persistent force in this expansion. (Annual auto sales peaked in 1978 and did not reach bottom until 1982.) The release of this pent-up demand, arising from the need to replace retired vehicles and from normal population growth--the baby boomers are now prime customers for the car makers--may explain why car sales have remained so buoyant and will likely continue to be relatively strong. Auto sales are expected to total 10.6 million units this year versus 9.2 million in 1983.

The factors underpinning pent-up demand for appliances and housing starts are similar to those affecting autos, although replacement demand is a much smaller consideration in housing. Note, however, that if auto sales, appliance sales, housing starts, etc., remain near current high levels, real GNP growth will slow; economic growth depends on a pattern of <u>rising</u> sales. Moreover, the expanding merchandise trade deficit is partially offsetting growth in these areas and is acting as a damper on real GNP growth.

Bernard Schoenfeld

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Economic Forecast

Percent Changes at Annual Rates

	Actual						Forecast	Actual		Forecast
	1983	1984					1985	1982-	1983-	1984-
	IV	I	II	III	IV	I	II	III	IV	1983	1984	1985
Gross National Product	9.2	9.3	7.3	7.6	10.9	9.9	8.1	10.3	10.5	7.7	9.3	9.4
Real GNP	4.9	4.5	3.0	3.0	5.8	4.5	2.5	4.0	4.0	3.3	4.9	4.0
GNP Price Deflator	4.2	4.6	4.2	4.5	4.8	5.2	5.5	6.0	6.3	4.2	4.2	5.2

	Actual	Forecast	Actual		Forecast
	1983: IV	1984: I	1982-1983	1983-1984	1984-1985
Consumer Spending	8.7%	10.6%	8.3%	9.0%	9.4%
Durable Goods	22.3	27.0	14.2	15.5	7.4
Nondurable Goods	4.4	10.3	5.6	7.6	6.6
Services	8.6	6.6	8.9	8.3	12.1
Business Capital Spending	32.0	10.7	0.2	16.1	14.2
Structures	12.5	6.7	-7.3	8.8	12.5
Equipment	44.4	13.0	5.3	20.6	15.1
Residential Investment	0.0	0.6	43.9	11.7	-2.5
			1983	1984	1985
Change in Inventories	$10.5b.	$13.0b.	$-8.7b.	$17.4b.	$32.0b.
Net Exports of Goods and Services	$-18.7b.	$-32.0b.	$-7.1b.	$-42.0b.	$-55.0b.
			1982-1983	1983-1984	1984-1985
Government Purchases	1.5%	12.8%	6.3%	7.5%	8.6%
Federal	-3.5	26.0	6.4	9.8	11.6
Defense	9.9	20.9	11.6	12.4	14.0
Other	-32.9	42.2	-5.4	3.1	4.8
State & Local	4.9	4.9	6.2	6.0	6.5
Corporate Profits Before Tax	32.2*	36.1*	18.2	19.2	10.0
Corporate Profits After Tax	24.5*	30.3*	13.1	15.2	10.0
Plant and Equipment Expenditures	19.8	7.9	-4.4	12.7	12.5
Real Final Sales#	4.8	4.2	2.9	4.2	3.6
Real Disposable Personal Income	7.9	2.2	3.2	4.9	4.0

Economic Indicators	Recent Data			Actual	Forecast	
	Nov.	Dec.	Jan.	1982-1983	1983-1984	1984-1985
Consumer Price Index**	3.6%	3.6%	7.2%	3.8%	4.3%	5.5%
Producer Price Index for Finished Goods**	-2.4	1.2	7.2	0.6	4.3	5.5
Industrial Production	3.6	7.2	13.2	6.5	9.8	4.8
Retail Sales##	1.2	0.1	2.2	9.1	9.6	8.6
				1983	1984	1985
Auto Sales (millions of units, a.r.)	9.5	10.5	11.2	9.2	10.6	10.8
Housing Starts (millions of units, a.r.)	1.73	1.67	1.92	1.70	1.80	1.60
Unemployment Rate	8.4	8.2	8.0	9.6	7.5	6.7
Merchandise Trade Deficit (a.r.)	$88.8b.	$75.6b.	$113.6b.	$69.4b.	$104.0b.	$120.0b.

Unless noted otherwise, all data are period-to-period percent changes at annual rates, derived from seasonally adjusted data.

#GNP less change in inventories, both in real terms.
##Monthly percent changes are not annualized.
$b. = billions a.r. = annual rate F = Forecast

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March 12, 1984

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Economic Outlook

Irving Trust

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Economic Research &
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April 1984

The economy advanced at a rapid clip in early 1984, but preliminary evidence indicates that growth is already slowing. Until the Federal Reserve has positive proof that the economy has cooled off, however, it will probably not relax its restrictive stance, although further increases in rates will likely be limited. Real GNP should decelerate from an annualized rate of about 7% in the first quarter to 2.5%-3.5% in the second and third quarters, with somewhat stronger growth for a few quarters thereafter. This pattern would result in a rise in real GNP of 4.4% from the fourth quarter of 1983 to the fourth quarter of 1984, just slightly below the average increase in the second year of prior recoveries.

The Administration's "flash" forecast of 7.2% real GNP growth in the first quarter was based primarily on January and February data, but most of the strength was in January. Real personal consumption expenditures rose sharply in January but then fell in February. Domestic auto sales went from 7.8 million units at an annual rate in December to 8.4 in January, 8.5 in February, and then fell to 7.9 in March. This decline in auto sales combined with unfavorable weather conditions probably produced a decline in total retail sales in March (on a seasonally adjusted month-to-month basis) after remaining flat in February. Other signs of a slowdown in March include a slight rise in initial claims for unemployment compensation benefits and a decline in the average workweek for manufacturing employees.

The normal performance of the economy--and this recovery has been remarkably normal in many respects--is to grow rapidly for a 12-15 month period and then pause for a while as incomes, sales, production, and inventories move into better alignment. Although businesses have generally been managing inventories unusually carefully in this recovery, it is likely that some of the substantial buildup in inventories during the first quarter was undesired, a situation that would lead to smaller increases in production in the months ahead.

Despite the suggestions above that a slowdown will likely be evident in the second or third quarters, the irony is that from one perspective economic growth has been too good. The Fed is having to work hard to offset the effects of a stimulative fiscal policy and substantial pent-up demand for housing, autos, and capital goods. Not surprisingly, given the strong real GNP growth in the first quarter, the narrowly defined money supply M1 has been near the top of its target range for most of this year--that is, at least since early February, when revised data showed more rapid M1 growth in prior months than had been estimated earlier.

The recently released minutes of the Federal Open Market Committee meeting on January 30-31 clarify Fed leanings. The target range for M2 was lowered slightly, partly for technical reasons. Some members of the Committee also favored lowering the target range for M1. Such reductions, it is believed, would "help to underscore the Committee's commitment to an anti-inflationary policy." Nevertheless, once the economy slows in response to the restrictive policy stance, and the monetary aggregates move within a more acceptable portion of their target ranges, the Fed would have the flexibility to allow rates to drift lower. As a result, by the latter part of 1984, rates may well be back near where they were at the beginning of the year.

Bernard Schoenfeld

Irving Trust

Economic Forecast

Percent Changes at Annual Rates

	Actual	1984				Forecast				Actual	Forecast	
	1983 IV	I	II	III	IV	1985 I	II	III	IV	1982-1983	1983-1984	1984-1985
Gross National Product	9.1	11.7	7.8	7.1	9.5	9.9	8.2	10.3	10.6	7.7	9.8	9.1
Real GNP	5.0	7.0	3.5	2.5	4.5	4.5	2.5	4.0	4.0	3.4	5.5	3.7
GNP Price Deflator	3.9	4.4	4.2	4.5	4.8	5.2	5.5	6.0	6.3	4.2	4.1	5.2

	Actual	Forecast	Actual	Forecast	
	1983: IV	1984: I	1982-1983	1983-1984	1984-1985
Consumer Spending	9.4%	10.8%	8.3%	9.3%	9.0%
Durable Goods	24.2	27.0	14.3	15.8	7.2
Nondurable Goods	5.1	10.7	5.7	7.6	6.5
Services	9.1	6.8	8.9	8.9	11.4
Business Capital Spending	28.8	27.2	0.0	19.6	14.2
Structures	7.8	39.6	-7.6	15.2	12.5
Equipment	42.7	20.7	5.2	22.3	15.2
Residential Investment	-7.3	33.2	43.2	16.4	-1.8
			1983	1984	1985
Change in Inventories	$19.6b.	$30.0b.	$-6.4b.	$19.1b.	$29.0b.
Net Exports of Goods and Services	$-26.1b.	$-40.0b.	$-9.0b.	$-49.5b.	$-60.0b.
			1982-1983	1983-1984	1984-1985
Government Purchases	0.4%	5.1%	6.2%	7.2%	8.5%
Federal	-5.6	4.0	6.2	9.0	11.7
Defense	10.5	19.3	11.6	12.6	14.0
Other	-39.5	-33.6	-6.0	-0.8	4.7
State & Local	4.6	5.9	6.2	6.0	6.3
Corporate Profits Before Tax	36.2*	41.4*	19.1	18.7	10.0
Corporate Profits After Tax	25.9*	35.3*	13.5	15.1	10.0
Plant and Equipment Expenditures	19.9	18.5	-4.4	13.7	12.5
Real Final Sales#	3.7	5.7	2.8	4.8	3.5
Real Disposable Personal Income	8.0	6.3	3.2	4.8	3.4

Economic Indicators	Recent Data			Actual	Forecast	
	Dec.	Jan.	Feb.	1982-1983	1983-1984	1984-1985
Consumer Price Index**	2.4%	7.2%	4.8%	3.8%	4.7%	5.4%
Producer Price Index for Finished Goods**	1.2	7.2	4.8	0.6	4.7	5.3
Industrial Production	6.0	14.4	14.4	6.5	10.2	4.7
Retail Sales##	0.5	3.8	-0.1	9.3	10.7	8.4
				1983	1984	1985
Auto Sales (millions of units, a.r.)	10.5	11.2	10.6	9.2	10.8	11.0
Housing Starts (millions of units, a.r.)	1.69	1.98	2.20	1.70	1.86	1.65
Unemployment Rate	8.2	8.0	7.8	9.6	7.5	6.7
Merchandise Trade Deficit (a.r.)	$80.8b.	$113.6b.	$121.1b.	$69.4b.	$112.5b.	$123.0b.

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April 9, 1984

#GNP less change in inventories, both in real terms.
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